



DEPARTMENT OF
FINANCE

ARNOLD SCHWARZENEGGER, GOVERNOR

915 L STREET ■ SACRAMENTO CA ■ 95814-3706 ■ WWW.DOF.CA.GOV

September 14, 2006

Ms. Mary-Ann Warmerdam, Director
Department of Pesticide Regulation
1001 I Street
Sacramento, CA 95814

Dear Ms. Warmerdam:

Final Report—Internal Control Risk Assessment

Enclosed is the final report on our internal control risk assessment of the Department of Pesticide Regulation (Department). This assessment was performed under an interagency agreement between the Department and the Department of Finance to facilitate compliance with the Financial Integrity and State Manager's Accountability Act of 1983.

The Department's response is included in the enclosed report. Implementation of the proposed corrective actions will help strengthen the Department's internal control and improve fiscal operations.

In accordance with Finance's policy of increased transparency, this report will be placed on the Finance website. We appreciate the assistance and cooperation of Department staff and management during our review. If you have any questions, please contact Richard R. Sierra, Manager, or Doris M. Walsh, Supervisor, at (916) 322-2985.

Sincerely,

Original Signed By: Janet I. Rosman

for Diana L. Ducay, Chief
Office of State Audits and Evaluations

Enclosure

cc: Mr. Paul H. Gosselin, Chief Deputy Director, Department of Pesticide Regulation
Ms. JoAnne Payan, Assistant Director, Administrative Services Division, Department of Pesticide Regulation

A RISK ASSESSMENT

Department of Pesticide Regulation Accounting and Administrative Controls

Prepared By:
Office of State Audits and Evaluations
Department of Finance

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The Department of Finance, Office of State Audits and Evaluations, conducted this risk assessment at the request of the Department of Pesticide Regulation (Department). The objective was to assess the Department's control of fiscal activities.

The Department, established in 1991 pursuant to the California Environmental Protection Agency reorganization plan, is responsible for administering programs that protect the public and environment from unsafe exposure to pesticides. The Department evaluates the public health and environmental impact of pesticide use; regulates, monitors, and controls the statewide sale and use of pesticides; and develops and promotes the use of reduced-risk practices for pest management. The Department is funded primarily by an assessment on the sale of pesticides.

This report is intended solely for the information and use of the Department. However, this report is a matter of public record and its distribution is not limited.

STAFF:

Richard R. Sierra, CPA
Manager

Doris M. Walsh
Supervisor

Ifeanyi Maduchukwu, CPA
Robert Castillo

EXECUTIVE SUMMARY

As of June 30, 2006, strengths were noted in the Department's income, expenditure, fixed assets, and information security functions. The Department has well-documented policies and procedures that play an important part in risk management. There were also a few areas of elevated risk, where corrective action is needed to minimize the potential for material errors, irregularities, and loss of assets, as noted below.

Cash Disbursements: Invoices were not paid timely and late payment penalties were not assessed, as required by the California Prompt Payment Act.

Fixed Assets: The Department has not completed a physical property inventory and reconciliation within the last three years. In addition, its property listing is incomplete and inaccurate. These risks were also noted during our 2004 review.

Information Technology: The Department has not completed a risk assessment of its information systems and did not timely file the required Operational Recovery Plan with the Department of Finance. As a result, information assets may be susceptible to theft, loss, or misuse.



MANAGEMENT LETTER

Ms. Mary-Ann Warmerdam, Director
Department of Pesticide Regulation
1001 I Street
Sacramento, CA 95814

We have completed a risk assessment/limited review of the Department of Pesticide Regulation's (Department) accounting, administrative, and fiscal information security controls in effect as of June 30, 2006. Our scope was to assess relative risks in the above-mentioned controls and did not constitute a comprehensive study and evaluation of the internal controls. We applied procedures to the extent we considered necessary; this included observations, analyses, interviews, and limited transaction tests. We did not assess programmatic controls over the operation and performance of the Department's mandated activities.

As summarized in the *Risks and Recommendations* section of this report, our assessment identified a number of internal control strengths and potential risks in the Department's fiscal activities.

Department management is responsible for establishing and maintaining adequate internal controls. The objective of internal controls is to provide reasonable, but not absolute, assurance that assets are safeguarded against loss from unauthorized use or disposition, and that transactions are executed in accordance with state control procedures, and recorded properly.

This report is intended solely for the information and use of Department management. However, this report is a matter of public record and its distribution is not limited.

Original Signed By: Janet I. Rosman

for Diana L. Ducay, Chief
Office of State Audits and Evaluations

June 30, 2006

SCOPE AND METHODOLOGY

The Department of Finance, Office of State Audits and Evaluations, conducted this risk assessment/limited internal control review at the Department's request. The assessment's purpose was to identify strengths and risks in the Department's accounting, administrative, and fiscal information security controls. Accounting and administrative controls comprise management's plan to ensure the safeguarding of state assets through adequate segregation of duties, restricted access, authorization, record keeping, policies and procedures, employment of qualified personnel, and internal review. Fiscal information security controls are designed to protect information assets, and include electronic data processing security, data integrity, risk management, and disaster recovery planning. We performed the following procedures:

- Verified operable internal controls, including but not limited to, processes and procedures for staff use, methods of assigning authority and responsibility, segregation of duties, and personnel policies and practices.
- Identified the risks of material misstatement in the accounting records due to error or fraud, and identified and evaluated internal controls by transaction cycle.
- Determined compliance with state information security and risk management policies applicable to fiscal transaction processing, including the appointment of an information security officer and effective disaster recovery planning.
- Identified areas of operations that are subject to risk from inadequate controls or non-compliance with established controls, and recommended corrective action to minimize these risks.
- Followed-up on findings identified in our 2004 assessment report, determined whether those findings had been corrected, and evaluated the effectiveness of corrective actions.

We did not review programmatic controls over the operation and performance of the Department's activities. Program controls include management's plan to ensure the efficient and effective operation of the Department's activities and programs, the achievement of desired results or benefits, and compliance with applicable laws and regulations.

To complete the above procedures, we: (1) interviewed Department staff and management; (2) reviewed accounting processes, administrative policies and procedures, information technology disaster recovery plans, and organization charts; (3) observed the safeguarding of cash receipts and blank check stock; (4) performed limited testing of bank reconciliations, timely and accurate recording of cash receipts, cash deposits, and remittances to the State Treasurer; and (5) reviewed and tested, on a limited basis, processes over purchasing, cash disbursements, equipment inventory, and claim schedules.

The following section includes our conclusions on control strengths and risks. The noted risks highlight areas warranting management attention.

RISKS AND RECOMMENDATIONS

Income Cycle

Effective receipt controls ensure that collections are adequately safeguarded and promptly recorded, subsidiary records are reconciled with control accounts and bank statements, and full cost recovery policies are followed.

Strengths

- Press-numbered receipts are used for cash collections.
- Cash receipt policies and procedures are adequately documented.
- Cash receipts are safeguarded, deposited timely, and recorded accurately.
- Accounts receivable are properly established and collected.
- Appropriate separation of duties exists over cash receipts and accounts receivable.

No risks were noted in the income cycle.

Expenditure Cycle

Effective disbursement controls ensure that all disbursements are properly approved and accurately recorded, checks and other negotiable instruments are safeguarded, check signing equipment is adequately controlled, disbursements are made only for allowable purposes, and bank accounts are timely reconciled.

Strengths

- Cash disbursement policies and procedures are adequately documented.
- Appropriate separation of duties exists over cash disbursements.
- Cash disbursements are properly supported and recorded.
- Reconciliations are performed monthly and contain the required signatures.

Risk Area 1—Vendors Are Not Paid Timely

The Department does not always process invoices and claim schedules timely to ensure that vendors are paid within 45 days. Payments ranged from 46 to 61 days after the invoice date. Late payments may impact the timely delivery of future goods and services, complicate the year-end reporting and reconciliation processes, and expose the Department to late payment penalties. The Department did not calculate and remit penalties to vendors.

The California Prompt Payment Act, Government Code Section 927 et seq., requires state agencies to automatically calculate and pay the appropriate late payment penalties (as specified in the State Administrative Manual (SAM) Section 8474.2) if they fail to pay invoices by the invoice due date or 45 calendar days, whichever is earlier. For invoice processing, 30 of the

45 days are allocated to the state agency and the remaining 15 days are allocated to the State Controller's Office.

Recommendation 1

Promptly schedule invoices for payment within 30 days of receipt. When required, calculate and remit any late payment penalties to vendors.

Fixed Assets Cycle

Effective fixed asset controls ensure that acquisitions and dispositions are properly authorized and timely recorded, accurate asset accountability is maintained, physical inventories are periodically conducted, and subsidiary records are reconciled with control accounts.

Strengths

- Property acquisitions and dispositions are properly authorized.
- Fixed assets duties are adequately segregated.

Risk Area 2—A Physical Inventory and Reconciliation Has Not Been Completed

The current property ledger is inaccurate, and the Department has not completed a physical inventory of its property and reconciled the inventory count to the accounting records. Listed equipment valued at approximately \$197,000 (consisting of a laptop computer, a microscope, one copier, and two information system servers) could not be located, and the Department was unable to explain their disposition. The property ledger also included many items for which no identification number was listed. As a result, the Department may be unable to maintain adequate control and accountability over fixed assets, or prevent undetected theft of property.

This risk was also noted in our 2004 review.

Additionally, the Department has not reconciled acquisitions and dispositions of capitalized property with amounts recorded in the property ledger. As a result, the general fixed assets balance was understated by \$33,576 compared to the property ledger, and the discrepancy was not detected by Department staff. The error was corrected after we notified Department management.

SAM Section 8652 requires departments to make a physical count of all property, reconcile the count with the accounting records at least once every three years, and maintain evidence of the physical inventory.

SAM Section 8650 requires departments to keep track of state property, whether capitalized or not, in a property accounting system that records the following information: (1) acquisition date, (2) description, (3) identification number, (4) cost or other valuation basis, and (5) fund.

SAM Section 7924 requires that, at least quarterly, agencies reconcile the acquisitions and dispositions of capitalized property with the amounts recorded in the property ledger.

Recommendation 2

- Conduct a physical inventory of all Department property and reconcile the account with the accounting records. Ensure that the inventory process is repeated at least once every three years.
- Update the property ledger to reflect complete and accurate information on all Department property.
- Reconcile monthly or quarterly, acquisitions and dispositions of capitalized property with amounts recorded in the property ledger.

Information Security

Effective information technology controls ensure that access to accounting system hardware and software is adequately controlled, data integrity is maintained, operational continuity plans exist, and key person dependency is avoided.

Strengths

- Hardware, software, and computer use policies are properly documented.
- System access is appropriate and consistent with assigned duties and employment levels.

Risk Area 3—Risk Assessment Procedures Have Not Been Completed

The Department has not conducted a system-wide risk assessment of vulnerabilities and consequences associated with daily operations, such as physical security and access, programming, systems documentation, protection of confidential information, separation of duties, and system reliability. Further, the Department had not filed a current Operational Recovery Plan with the Department of Finance until after we notified its management of the requirement.

SAM Section 4842.1 requires all agencies to establish a risk analysis process to identify and assess risks associated with its information assets and develop a cost-effective approach to managing those risks; and Section 4843.1 requires each agency to maintain, and file with the Department of Finance, an Operational Recovery Plan identifying its critical computer applications, the information assets for those applications, and the agency's plans for resuming operations following a disaster affecting those applications.

SAM Section 4840 describes the required risk management and disaster recovery planning processes for identifying, assessing, and responding to the risks associated with information assets.

Recommendation 3

- Conduct a system-wide risk analysis to identify, assess, and manage risks associated with the Department's information assets.
- Timely file an Operational Recovery Plan (or certification, if no change) annually with the Department of Finance.

CONCLUSION

Strengths were apparent in a number of areas, indicating that the Department has taken appropriate steps to manage its accounting, administrative, and fiscal information systems and controls. The Department recognizes and communicates to its employees the importance of maintaining effective internal controls. To assist the Department with its ongoing risk management program, we identified areas of potential risk and recommended corrective action to reduce these risks.

Our work was limited to those areas specified in the *Scope and Methodology* section of this report, based on fieldwork performed between May 9, 2006 and June 30, 2006.



Department of Pesticide Regulation



Mary-Ann Warmerdam
Director

MEMORANDUM

Arnold Schwarzenegger
Governor

TO: Diana L. Ducay, Chief
Office of State Audits and Evaluation
Department of Finance
915 L Street, Sacramento, CA 95814

FROM: JoAnne Payan
Assistant Director/Chief Information Officer
Administrative Services Division
(916) 445-4140

DATE: August 30, 2006

SUBJECT: Draft Report – Internal Control Risk Assessment

The Department of Pesticide Regulation (DPR) has reviewed the draft report for the internal control risk assessment dated July 2006.

Having been briefed at the exit conference regarding the strengths and risks identified in our accounting and administrative controls, DPR accepts the findings noted in the Executive Summary. Following is a brief synopsis of our action(s) or intended action(s) to address the identified risks:

Cash Disbursements: Training will be given to a new staff member in the accounts payable position and will stress the importance of processing invoices for payment in a timely manner. To facilitate this, we have also streamlined the invoice approval process. This has shortened the time between receiving the invoice, obtaining program approval and claim scheduling the invoice for payment. A new Accounting Office Manager is in place and will ensure that this process is completed accurately and timely. In the event that we are unable to meet proper deadlines, we will fulfill the requirement to calculate and remit late payment penalties.

Fixed Assets: DPR will conduct a physical inventory of all department property in October 2006 and will reconcile the account with the Accounting Office. All property will be decaled for identification in order to maintain adequate control and accountability. A file will be created for evidence of physical inventory. Upon completion of the physical inventory, DPR will ensure that the property ledger is updated and that it reflects complete and accurate information for all department property. DPR will reconcile monthly the acquisitions and disposition of capitalized property with the amounts recorded in the property ledger.

Information Technology: The filing date of DPR's Operation Recovery Plan (ORP) was extended by Tony Poon with the Department of Finance's (DOF) Information Security Office until October 15, 2006 (please see memo dated May 30, 2006). The ORP was updated in March 2006, however the process of filing a copy with the DOF was overlooked during the Information



Recipient's Name
August 30, 2006
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Technology Branch (ITB) transition to a centralized governance model last year. DPR's ORP will be submitted to the DOF October 15, 2006.

In accordance with SAM section 4842.1, DPR will include a system wide risk analysis function in the ITB Operation Plan, as a task to be completed when resources permit.

As noted in our request for the DOF's assistance with DPR's compliance with the Financial Integrity and State Manager's Accountability Act, we are pleased to receive both your acknowledgement of the strengths we have in the areas of policies and procedures, income, expenditures, fixed assets and information security functions. We take seriously your observations about elevated risk areas requiring corrective action and wish to convey that we will endeavor to address those shortcomings insofar as existing staff resources allow.

Please feel free to contact me at 445-4140 should you require additional information or clarification as you finalize your report.

cc: Mary-Ann Warmerdam, Director
Paul Gosselin, Chief Deputy Director
Linda Crough, Branch Chief
Angelique Rust, Office Manager
Anise Severns, Office Manager
Larry Wasson, Branch Chief
Adrianne Watson, Office Manager

Attachment